

MINUTES
BOARD OF TRUSTEES OF THE
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 500
Indianapolis, IN 46204
October 10, 2003

EXECUTIVE SESSION

Trustees Present

Jonathan Birge, Chair
Richard Doermer, Vice Chair
Garland E. Ferrell
Connie R. Thurman
Robert V. Welch

Others Present

Craig Hartzler, PERF Executive Director
Bruce Kimery, PERF Deputy Executive Director/Chief Benefits Officer
Leisa Julian, PERF General Counsel
Forrest Bowman, Attorney at Law, Bowman Cosby & Bowman

The Board met in Executive Session to discuss matters under IC 5-14-1.5-6.1(b)(2)(B).

REGULAR SESSION

Trustees Present

Jonathan Birge, Chair
Richard Doermer, Vice Chair
Garland E. Ferrell
Connie R. Thurman
Robert V. Welch, Jr.

Others Present

Mary Beth Braitman, Ice Miller
Stephanie Braming, Mercer
Douglas Todd, McCready & Keene, Inc.
Elaine Beaty, McCready & Keene, Inc.
Lilian Wan, BGI
Barton Warrick, BGI

PERF Staff

Craig Hartzler, PERF Executive Director
Bruce Kimery, PERF Deputy Executive Director/Chief Benefits Officer
Leisa Julian, PERF General Counsel

Patricia Gerrick, PERF Chief Investment Officer
Tim Legesse, PERF Investment Analyst
Mark Willis, PERF Investment Analyst
Bill Moran, PERF Compliance Administrator
Joseph Duncan, PERF Investment Analyst
Diann Clift, PERF MIS Director
Michael Horstman, PERF Chief Financial Officer
Caroline Bradley, PERF Internal Auditor
Cindy Osborne, PERF Minute Writer

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

- A. Agenda of October 10, 2003 Meeting
- B. Minutes:
 - September 12, 2003 Board of Trustees Meeting

I. APPROVAL OF MINUTES

MOTION duly made and carried to approve the Minutes of the September 12, 2003 Board of Trustees Meeting.

Proposed by: Garland Ferrell

Seconded by: Connie Thurman

Votes: Five in favor, 0 against, 0 abstentions.

II. OLD BUSINESS

There was no old business discussed.

III. NEW BUSINESS

- A. BGI Presentation. Ms. Gerrick introduced Lilian Wan from BGI. Ms. Wan gave a brief description of herself and what she does. Ms. Wan then introduced and gave a brief bio of the presenter Barton Waring.
 - Mr. Waring discussed that investment policy is about balancing the desire for reward against the sure fact that as we work harder to get more rewards, we're going to take on more risk. Mr. Waring presented the following information for review by the Board.
 - Why Measure Risk Using Standard Deviations: The "Bell Curve"

- Example: Risk in the US Equity Market
- Defined Benefit Plan Investing: Asset Only
 - Focused on investing the assets, only loosely linked to the benefit liability.
 - Formal Objective: Maximize expected return on assets at a given level of investment risk.
- The Board's Task: How Much Risk?
 - Objective: Maximize growth of surplus (reduction of deficit) while controlling level of risk surplus (deficit).
 - Continuum of choice: "perfect" hedging, or take some risk in search of return?
- Strategic Asset Allocation Policy
 - Opportunity – To invest more aggressively than the liability benchmark in the expectation of earning higher returns.
 - Risks – You risk underperforming the liability benchmark.
 - Tasks and Accountabilities.
 1. Evaluate the market related nature of the liability and design an investment opportunity set from which a "surplus efficient frontier" can be calculated.
 2. Decide whether to invest more aggressively than the liability, and by how much.
- Active Management is Hard
 - Active management is a zero sum game – a negative sum game after fees and costs. The exception to the law of averages: you must have skill – skill at picking managers that have skill at picking securities.
 - Secondary objective: Maximize expected alpha while controlling active risk.
 1. Opportunity: To add return through skillful selection of skillful managers.
 2. Risk: You may subtract value.
 - Tasks and Accountabilities
 1. Board: Decide how much active risk to take, and in which asset classes.
 2. Board, consultants, and/or staff: Select with skill the active managers, or set up a system within which the staff and consultants will do so, in order to deliver positive alpha.
 3. Managers: To deliver positive alpha.
- Why Do Risk Controlled Active Strategies Have Higher IRs?

- The long-only constraint means some information is wasted. As fund volatility increases, the manager loses more information because of the need to take larger over and underweights. The constraint impacts long positions because overweights and underweights must balance.
- Why Risk Controlled Active Strategies?
 - The long-only constraint causes a loss in efficiency. The information ratio (IR) decreases as uncompensated risk increases. Stock based enhanced indexing strategies by design have a higher expected IR than traditional active strategies with similar information.
- Active Management: It's Hard, But It Can Be Done Well

B. Mercer Recommendations

- Ms. Braming from Mercer discussed the analysis that Mercer put together after last month's presentation. These recommendations directly relate back to the goals that the Board established in the PERF investment policy.
- Mercer recommended increasing the allocation to treasury inflation protected securities. The reason for this is from the liability perspective when paying benefits and the cost of living adjustments the Fund incorporates, the liabilities are very sensitive to inflation. Having an inflation hedge on the asset side is expected to help in strong inflationary environments.
- The second conclusion was to slightly increase the international equity exposure because it does provide diversification benefits.

C. Preliminary/Unaudited 3rd Quarter Performance Report

Ms. Gerrick discussed the preliminary look at the numbers from the month of September. Equity markets were down. For the quarter ending in September, there was a strong rally in the equity market. Ms. Gerrick explained that if you look at all the large cap equity managers for the last quarter, they returned 3.9% which matches the Russell 1000 growth. Our overall portfolio did well for the quarter, and also did well for the year to date. Ms. Gerrick explained the international equity for the year to date, EAFE was up 18.8%. ex US, our international benchmark, was up 20.7%. Brandes was up 25%. Our fixed income allocations had a decline earlier in the month of July, but has rallied in the month of

September. Although for the quarter the fixed income numbers were not positive. Ms. Gerrick explained that most of the managers are now out performing their assigned benchmark. We are underweight Large Cap Equity, we're overweight Mid Cap Equity and International Equity. We continue to be overweight Fixed Income. We are still underweight Global Equity. Ms. Gerrick explained that we have not gotten away from GE yet and she recommended hiring Invesco to help transition away from GE as soon as possible. She said she is recommending Invesco because she feels they are the most qualified to protect the portfolio. She also noted that the reason she feels PERF should act now is because traditionally December is a low time of the year due to a dip in liquidity for international securities.

MOTION duly made and carried for the Board to take action to temporarily place the GE holdings with Invesco and the uncrossed securities from the GE portfolio with Baillie Gifford until the Board can pick a new international value manager at its November meeting.

Proposed by: Richard Doermer

Seconded by: Connie Thurman

Votes: Five in favor, 0 against, 0 abstentions

D. Actuarial Studies

Mr. Todd gave a break down of five Actuarial Valuations. He noted that they were routine except for the recent poor investment results. Some of the plans and contribution amounts have gone up and some have gone down. Fortunately, they haven't gone down a great deal. Mr. Todd also explained that these are the first valuations using the new reporting system from Covansys. Mr. Todd noted that they are still working out the kinks with this transition. He also noted that the 1977 fund is actuarially funded and was created to phase out the 1925, 1937 and 1953 plans which are not actuarially funded, but on a pay-as-you-go system. Mr. Todd detailed a four-year history of the following plans:

1. 1977 Police Officers' and Firefighters' Pension and Disability Fund and 1925, 1937 and 1953 Municipal Police and Fire Pension Plans
2. Judges' Retirement System
3. Excise Police and Conservation Officers' Retirement Plan
4. Prosecuting Attorneys' Retirement Fund
5. Legislators' Defined Benefit Plan

MOTION duly made and carried to accept the actuarial reports.

Proposed by: Garland Ferrell
Seconded by: Robert Welch
Votes: Five in favor, 0 against, 0 abstentions.

E. Budget Issues

- Financial Update – Mr. Kimery noted that we are doing fine in terms of budget and actual right now. The PERF head count is at 93 positions with 107 budgeted. Mr. Kimery noted that the additional funding requests for a total of \$850,000.00 are broken down into three categories; Forensic Audit, Security, and Legal Services.
 - ❑ The amount of the Forensic Audit is \$235,250.00. This is an updated number, but may not be the final number.
 - ❑ Security initiatives are \$518,500.00. This is the result of the CSC cyber and fiscal security review and includes installing a firewall between PERF and the State network. We're also looking at having security personnel in both buildings at \$39,000.00 which is included in the \$518,500.00 to address that issue.
 - ❑ Litigation requires an additional \$96,250.00.

Mr. Hartzer noted that we would report to the Board on a monthly basis where we stand on these issues.

MOTION duly made and carried to accept the additional \$850,000 funding request.

Proposed by: Garland Ferrell
Seconded by: Robert Welch
Votes: Five in favor, 0 against, 0 abstentions.

F. Legal Strategy

Mr. Hartzer noted that pending litigations matters require authorization to hire outside counsel to handle these matters.

MOTION duly made carried to retain Bingham McHale, Attorneys at Law, as special litigation counsel to represent PERF in the initiation and pursuit of any and all litigation, proceedings, claims and disputes arising from the hiring and employment of any person or persons at PERF who are, have been or may be charged with a crime relating to their employment at PERF, including any ancillary

litigation, proceedings, claims, or disputes arising from or relating in any manner to the hiring and employment of those persons. In addition, we authorize the Executive Director to act as Fund's agent in effectuating and protecting PERF's interest in any proceeding related to these matters.

Proposed by: Robert Welch
Seconded by: Garland Ferrell
Votes: Five in favor, 0 against, 0 abstentions.

MOTION made and duly carried to retain Gibbs & Bruns LLP as special litigation counsel to represent the Fund's interest in bringing potential claims in connection with the National Century Financial Enterprises, NPF XII, Inc. and related Debtors' bankruptcy proceedings, and to authorize the Executive Director of PERF to act on the Fund's behalf to effectuate and protect the interest of PERF in this litigation.

Proposed by: Robert Welch
Seconded by: Garland Ferrell
Votes: Five in favor, 0 against, 0 abstentions.

MOTION duly made and carried to adopt resolution number 03-08 regarding the delegation of certain personnel related duties to the Executive Director.

Proposed by: Garland Ferrell
Seconded by: Richard Doermer
Votes: Five in favor, 0 against, 0 abstentions.

G. Benefits Committee Report

In a brief report summary, Mr. Kimery noted that PERF continues to try to reach all the goals that were set for benefits regarding the payment of people within 60 days. Mr. Kimery noted that we are now running refund checks in the system once a month, which is a big help for PERF. Mr. Kimery noted that we have several ongoing actions that will be coming up in the next 90 – 120 days. One is having a recordkeeper for the Legislators' Defined Contribution Plan in place by the 1st of January. The \$180 minimum benefit retirement payment that goes into effect for the payments in January if someone other than an elected official is receiving a retirement check of less than \$180. Mr. Kimery also noted that we have several ongoing initiatives to improve the quality of some operational processes.

IV. EXECUTIVE DIRECTOR REPORT

Mr. Hartzler noted that most of the issues that were in his Executive Director report have already been covered. Mr. Hartzler did note the good work from Ms. Clift and her colleagues in getting back on track after SIRIS system failures.